

**United States Bankruptcy Court
Northern District of Illinois
Eastern Division**

Transmittal Sheet for Opinions for Posting

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Bankruptcy Caption: In re Lisa Ray

Bankruptcy No. 98 B 38634

Adversary Caption:

Adversary No.

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Appearance of Counsel:

Attorney for Movant or Plaintiff: Ronald Peterson

Attorney for Respondent or Defendant: Melvin Kaplan

Trustee: Ronald Peterson

**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

In Re:)	Chapter 7
)	
Lisa Ray,)	Case No. 98 B 38634
)	
Debtor.)	Hon. Robert E. Ginsberg

Memorandum Opinion and Order

The Debtor in this chapter 7 case, Lisa Ray (“the Debtor”), claims an exemption in the portion of her 1998 federal income tax refund attributable to an earned income credit. The Chapter 7 Trustee, Ronald R. Peterson (“the Trustee”), objects to the exemption the Debtor claims in the earned income credit. The matter has been briefed and is before the court for determination.

Facts

The Debtor filed a voluntary chapter 7 petition on December 2, 1998. The Debtor did not originally include any anticipated 1998 federal tax refund on her schedule of personal property, filed in accordance with Federal Rules of Bankruptcy Procedure 1007. See Schedule B, item 17.

On January 15, 1999, the Trustee conducted the meeting of creditors mandated by section 341 of the Bankruptcy Code. 11 U.S.C. sec. 341. According to the Trustee, in response to the Trustee’s questions at the first meeting of creditors, the Debtor disclosed that she expected a 1998 federal tax refund, similar to the federal tax refund she received in 1997. At the time of the meeting of creditors, the Debtor had not yet filed her 1998 federal tax return. The Debtor filed her 1998 federal tax return on March 1, 1999. The tax return indicated that she was entitled to a refund of \$3,911: \$3,756 as an earned income credit and \$155 as an overpayment of taxes

withheld by her employer. On March 3, 1999, the Debtor advised the Trustee that she would receive \$3,911 as a tax refund from the Internal Revenue Service. On March 3, 1999, the Debtor filed an amendment to her Schedule B to include the federal tax refund as an asset, and amended Schedule C to claim the \$3,756 of the federal tax refund as exempt under Illinois law.

Jurisdiction and Procedure

The Court has jurisdiction over this matter under 28 U.S.C. sec.1334 as a proceeding arising under section 522 of the Bankruptcy Code. This matter is a core proceeding under 28 U.S.C. sec.157(b)(2)(B) as relating to the determination of exemptions and is before this Court pursuant to Local Rule 2.33 of the United States District Court for the Northern District of Illinois automatically referring bankruptcy cases and proceedings to this Court for hearing and determination.

Discussion

An earned income credit is created by the Internal Revenue Code. It is a refundable tax credit intended to benefit low income workers. 26 U.S.C. sec. 32. The Internal Revenue Code provides in part:

(a) Allowance of credit—

(1) In general. In the case of an eligible individual, there shall be allowed as a credit against the tax imposed by this subtitle for the taxable year an amount equal to the credit percentage of so much of the taxpayer's earned income for the taxable year as does not exceed the earned income amount. 26 U.S.C. 32(a).

According to the United States Supreme Court,

“[T]he earned-income credit was enacted to reduce the disincentive to work caused by the imposition of Social Security taxes on earned income (welfare payments are not similarly taxed), to stimulate the economy by funneling funds to persons likely to spend the money immediately, and to provide relief for low income families hurt by rising food and energy

prices.” (footnote omitted). *Sorenson v. Secretary of the Treasury*, 475 U.S. 851, 864 106 S.Ct. 1600, 1608-9 (1986).

An individual taxpayer will receive an earned income credit against federal taxes if his/her earned income is below a certain amount, and if the individual is not properly claimed as a dependent by another taxpayer. The amount of the earned income credit against taxes phases out as the taxpayer’s income rises. The amount of the credit is calculated according to a complex formula. 26 U.S.C. sec. 32(b).

The Debtor takes the position that her earned income tax credit is a “public assistance benefit” as that term is used in Illinois’ exemption statute. See 735 ILCS 5/12-1001(g)(1).¹ The Trustee disagrees. The Trustee contends that the earned income tax credit is not a public assistance benefit,² and that the Debtor’s bad faith in claiming her exemption only after getting caught omitting the right to a refund from her schedules precludes her claim for an exemption in the earned income tax credit.

Property claimed as exempt is exempt unless a timely objection to the exemption is made. 11 U.S.C. 522(1). See *Taylor v. Freeland & Kronz*, 503 U.S. 638, 642 (1992). The objecting party has the burden to establish that the exemption is not properly claimed. See *In re Ritter*, 190

¹ The Illinois exemption statute provides in relevant part:

Personal property exempt. The following personal property, owned by the debtor, is exempt from judgment, attachment, or distress for rent:

(g) The debtor’s right to receive:

(1) a social security benefit, unemployment compensation, or public assistance benefit....

735 ILCS 5/12-1001(g)(1).

² Neither the Trustee nor the Debtor question whether the refund is property of the estate. The overwhelming majority of courts addressing the issue of whether an earned income credit is property of the estate have held that it is. See *In re Johnson*, 222 B.R. 552, 553 (6th Cir. BAP 1998)(cases cited therein).

B.R. 323, 325 (Bankr. N.D. Ill. 1995). In the instant matter, the Trustee, as the objecting party, has the burden of establishing that the Debtor cannot properly claim an exemption in the earned income tax credit.

The Debtor can exempt the portion of her tax refund which is attributable to the earned income credit only if such property is exempt under Illinois law. Illinois law governs the determination of whether property is exempt from the Debtor's bankruptcy estate because Illinois has opted out of the exemptions available to debtors under section 522(d) of the Bankruptcy Code. 11 U.S.C. sec. 522(b)(1). Instead, the Illinois legislature has chosen to limit Illinois debtors in bankruptcy cases to those exemptions available to them under Illinois law and federal nonbankruptcy law. See 735 ILCS 5/12-1001(g).

The issue of whether an earned income tax credit is a public assistance benefit under the Illinois exemption statute has been addressed in two recent decisions by bankruptcy judges in the other two federal judicial districts in Illinois, *In re Fish*, 224 B.R. 82 (Bankr. S.D. Ill. 1998) and *In re Brockhouse*, 220 B.R. 623 (Bankr. C.D. Ill. 1998). In *Brockhouse*, the court held that earned income credits were exempt as public assistance benefits under the Illinois exemption statute and denied the trustee's objection to the debtor's claimed exemption. The complementary purposes of the earned income credit and the exemption statute were important to the *Brockhouse* court's decision: the purpose of the earned income credit is to help working poor families meet basic expenses, and the purpose of the exemption statute is to protect poor debtors and their families from being left completely destitute. The relationship of these goals, particularly when viewed in light of the effect of exemptions on the Bankruptcy Code's fresh start policy, led the

court to conclude that the debtor's earned income tax credit was exempt. *Brockhouse*, 220 B.R. at 625.

Similarly, in *Fish*, the court found that earned income tax credits were exempt under Illinois law as public assistance benefits. The *Fish* court found that exempting tax credits, which credits were intended to help needy families, furthered Congress' intent to help low income workers in creating earned income tax credits. In reaching its conclusion, the *Fish* court also was persuaded by cases in which the court had held that earned income tax credits were exempt under various' states laws, as well as the Seventh Circuit's admonition in *Matter of Barker*, 768 F.2d 191, 196 (7th Cir. 1985) to liberally construe exemption statutes in favor of debtors. *Fish*, 224 B.R. at 85.

This court agrees with the logical and well-written opinions of its colleagues in *Barker* and *Fish*. Although the Illinois exemption statute does not expressly exempt earned income credits, and instead uses the statutorily undefined term "public assistance benefit," common sense compels this court to find that earned income tax credits are exempt as "public assistance benefits" under Illinois law. *Fish*, 224 B.R. at 84. Compare *In re Collins*, 1999 WL 149813 (5th Cir. 1999)(earned income credits not exempt under Louisiana law as "assistance" because it was not a money payment, as required by Louisiana law); *In re Brown*, 186 B.R. 224 (Bankr. W.D. Ky. 1995)(earned income credits exempt under Kentucky definition of "public assistance.") The earned income credit aids the working poor. Congress intended the credit to encourage individuals to work by removing the disincentives to work created by certain taxes, *Sorenson*, 106 S.Ct. at 1608-09, and likely intended to exempt earned income payments, *In re Beagle*, 200 B.R.

595 (Bankr. N.D. Ohio 1996). These purposes are consistent with the goals of the Illinois exemption statute.

The purpose of the Illinois exemption statute is to protect debtors and their families by ensuring that they have the basic necessities to provide for their welfare in difficult economic times. *Brockhouse*, 220 B.R. at 624. Because the earned income tax credit works to put money in the hands of poor so that they can provide for their basic needs, and the Illinois exemption statute seeks to keep resources sufficient to provide for these basic needs in the hands of a debtor, an earned income tax credit should be seen as being a public assistance benefit. Accordingly, the court concludes that the Debtor's earned income credit is exempt under Illinois law, which controls in this proceeding.

The Trustee also contends that the Debtor's exemption in the earned income credit should be disallowed because she attempted to conceal her tax refund. The Trustee claims that the Debtor disclosed her refund only after he asked her pointed questions at the meeting of creditors and requested a copy of her 1998 tax return. It is the Trustee's position that the Debtor should not be able to amend her Schedule B to include the federal tax refund as an asset, and then amend schedule C to exempt the earned income portion of the federal tax refund since the Debtor filed these amendments only after the Trustee foiled the Debtor's attempt to conceal the refund. Whether the Debtor intended to abuse the bankruptcy system when she failed to include her anticipated refund in her schedules is a factual question. This question of fact can only be resolved by the court after an evidentiary hearing.

Conclusion

For the reasons stated above, an evidentiary hearing on the Trustee's objection to the Debtor's claimed exemption in her tax refund is set for July __, 1999 at _____.

ENTERED:

Dated: June 23, 1999

Robert E. Ginsberg
United States Bankruptcy Judge